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UNITED STATES GENERAL ACCOUNTING OFFICE

Review Of The Operations Of Fresno Development Company In The Fresno, California, Model Cities Program B-171500

Department of Housing and
Urban Development

BY THE COMPTROLLER GENERAL
OF THE UNITED STATES

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JUNE 27 1973

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D C 20548

B-171500

The Honorable B F Sisk
House of Representatives

Dear Mr Sisk

As you requested on February 17, 1972, we reviewed the operations of the Fresno Development Company in the Fresno, California, Model Cities Program

We obtained comments on the draft report from the Department of Housing and Urban Development, which is responsible for the overall administration of the Model Cities Program The Department incorporated in its comments the comments of the city of Fresno and the Fresno Development Company

We have made recommendations to the Secretary of Housing and Urban Development, and as agreed with your office, we will send a copy of the report to him We will send copies to the Senate and House Committees on Appropriations and Government Operations.

We do not plan to distribute this report further unless you agree or publicly announce its contents

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

CDA	city demonstration agency
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
SBA	Small Business Administration

COMPTROLLER GENERAL'S REPORT TO THE HONORABLE B F SISK HOUSE OF REPRESENTATIVES

REVIEW OF THE OPERATIONS OF FRESNO DEVELOPMENT COMPANY IN THE FRESNO, CALIFORNIA, MODEL CITIES PROGRAM
Department of Housing and Urban Development B-171500

D I G E S T

WHY THE REVIEW WAS MADE

At the request of Congressman B F Sisk, GAO reviewed the operations of the Fresno Development Company, a California nonprofit corporation responsible for economic development activities in the Fresno Model Cities Program

The Department of Housing and Urban Development (HUD) is responsible for administering the Model Cities Program at the Federal level The Fresno City Demonstration Agency--a department of the city's government--is responsible for developing and administering the program in Fresno

The demonstration agency contracted with the Fresno Development Company to plan and organize the economic component of the program

The company's objective was to increase business activity and meaningful employment opportunities in the model neighborhood

GAO evaluated the adequacy of fiscal controls over use of Model Cities funds and the company's effectiveness in accomplishing program objectives

FINDINGS AND CONCLUSIONS

The demonstration agency gave the company about $1,540,000 of HUD Model Cities funds for its first 2 action years The company also received loans and grants from other Federal agencies and loans from local banks

Industrial recruitment projects

During the first 2 action years of the Model Cities Program, the company implemented, at a total cost of about $1,985,000, seven industrial recruitment projects for providing employment for model neighborhood residents Five of these projects--which were privately owned businesses--also received funds from other sources The five projects did not accomplish their objectives and were discontinued

The two remaining projects, operated directly by the company, were in the early stages of development when GAO finished its fieldwork

Although the seven projects did create some temporary jobs, they did not create any permanent jobs

GAO found that the company had not

--Adequately evaluated the feasibility of proposed projects

--Obtained property appraisals before acquiring land for project sites The prices paid for land for two projects exceeded those paid for comparable lands sold in the same general area

--Coordinated its land purchases

Tear Sheet Upon removal the report cover date should be noted hereon with the Fresno Redevelopment Agency--the agency responsible for developing HUD's Urban Renewal Program in Fresno--and thus had not obtained the benefit of the redevelopment agency's real estate and land development expertise (See pp 9 to 18)

Small business loans

The company implemented a small business development program to develop and assist resident-owned small businesses which would provide employment for model neighborhood residents

The company made 46 loans to businesses and participated, with the Small Business Administration and local banks, in 3 loans The 49 loans made by the company amounted to about $218,800 The company also guaranteed Small Business Administration and local bank loans totaling about $588,600

GAO reviewed 18 company loans totaling about $54,000 and the 3 joint loans, of which the company's share totaled about $78,000 Only 3 full-time and 8 part-time jobs were created for model neighborhood residents as a result of the 21 loans Of the loans made by or participated in by the company, 11 were delinquent and 6 had defaulted and had been written off by the company

GAO believes that the small business development program's lack of success was due partly to the lack of an adequate evaluation of the potential for success of the businesses and the lack of an adequate evaluation of the capabilities of the loan recipients. The small business development component was dropped from the program for the third action year (See pp 19 to 25)

Financial management

HUD's financial management guidelines for city demonstration agencies required that their financial records include complete explanations of all expenditures The guidelines also included criteria for the types of costs eligible for payment from Model Cities funds

The demonstration agency's first- and second-year contracts required that the company adhere to HUD's financial management guidelines

GAO reviewed the company's support for the $30,037 it disbursed during 1 month of the second action year and found that expenditures totaling $5,621 either were not fully supported or were ineligible for payment from Model Cities funds

GAO's review of the company's expenditures totaling $145,867 to 22 contractors during the first 2 action years disclosed that the company had paid

--4 contractors a total of $22,971, although written contracts had not been executed,

--5 contractors fees totaling $21,131 for services which were performed after the contracts expired or which exceeded the total contract amounts, and

--12 contractors fees totaling $62,345, although the contractors had not submitted proof that they had performed services required by the contracts

The demonstration agency established controls over the company's expenditures during the third action year (See pp 26 to 29)

Demonstration agency's monitoring and evaluation of company's performance

HUD requires city demonstration agencies to monitor and evaluate activities of agencies operating Model Cities projects These evaluations, which should be made timely, should help determine whether the agencies are accomplishing their objectives

They also should be a basis for revising projects to make them more effective or for terminating projects that have little potential for success

GAO found that the demonstration agency did not monitor and evaluate the company's activities during the first 2 action years The agency did, however, hire a consulting firm to review selected Model Cities projects, including the company's projects The consultant's report was not issued until the middle of the agency's second year and therefore its value as a basis for timely revising or terminating any of the company's second-year projects was limited

GAO believes that proper monitoring and evaluation of the company's activities would have disclosed weaknesses in its industrial recruitment, small business development, and financial management activities. The demonstration agency has initiated actions which should provide a basis for improved monitoring and evaluation of the company's program (See pp 30 to 32)

RECOMMENDATIONS

The Secretary of Housing and Urban Development should

--Insure that, before the company undertakes projects, the demonstration agency enforces its requirements that the company (1) evaluate the feasibility of proposed projects and (2) submit information on project selection to the agency for review and approval (See p 17)

--Have the demonstration agency require the company to coordinate its efforts with the redevelopment agency (See p 18)

--Revise HUD guidelines to require appraisals of fair market value of properties to be acquired for Model Cities projects (See p 18)

--Have the demonstration agency require the company to take appropriate action to collect all delinquent small business development loans (See p 25)

AGENCY ACTIONS AND UNRESOLVED ISSUES

GAO sent its draft report to HUD for comment. HUD incorporated in its comments the comments of the city of Fresno and the company

Regarding the company's industrial recruitment projects, HUD said that, although numerous errors in decisions and procedures related to increasing employment opportunities were evident in the company's first 2 years of operations, recent developments were encouraging

The company's executive director stated that any future projects the company might undertake must insure sustained and lasting employment opportunities for model neighborhood residents In addition, HUD said that the company had established new lines of communication with the redevelopment agency and was committed to fully cooperating with that agency on all present and future projects (See p 18)

Regarding the company's small business development program, HUD said that repayment of loans made to three businesses by the company, in conjunction with local banks and the Small Business Administration, was current and that model neighborhood residents were being employed by the three businesses Litigation had been entered into for other delinquent accounts to minimize the amount of delinquencies (See p 25)

CHAPTER 1

INTRODUCTION

At the request of Congressman B. F. Sisk (see app. I), we examined into the operations of the Fresno West Development Company,[1] a California nonprofit corporation responsible for economic development activities in the Fresno Model Cities Program. Primarily we evaluated the adequacy of the fiscal controls over the use of Model Cities funds and the company's effectiveness in accomplishing program objectives

The Model Cities Program was established by title I of the Demonstration Cities and Metropolitan Development Act of 1966 (42 U.S.C. 3301). The program's objective was to demonstrate that the living environment and general welfare of persons living in slum and blighted neighborhoods could be substantially improved through a comprehensive and coordinated Federal, State, and local effort

The Secretary of Housing and Urban Development is administratively responsible for the program. At the local level city demonstration agencies (CDAs) are responsible for developing and executing the Model Cities Programs. CDAs may be administrative units of city or county governments or separate local public agencies responsible to the sponsoring cities or counties. CDAs, essentially planning and coordinating organizations, usually arrange for the administration of Model Cities projects through existing local agencies or through new agencies created to operate specific aspects of the programs.

The Department of Housing and Urban Development (HUD) grants the cities up to 80 percent of the costs of developing their Model Cities plans. These funds are used to identify the needs of the model neighborhoods, develop new and improved projects and activities, and involve model neighborhood residents in planning comprehensive Model Cities Programs.

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[1]In March 1972 the company's name was changed to Fresno Development Company.

After approval of the cities' programs, HUD grants funds to pay 80 percent of the CDAs' administrative costs and up to 100 percent of the costs of implementing projects and activities in the HUD-approved Model Cities Programs. The amounts of the funds that HUD grants to cities are established by taking into account the number and intensity of economic and social problems in the model neighborhoods These funds are generally referred to as Model Cities supplemental funds.

HUD selected 150 cities to participate in the program As of December 31, 1972, HUD had granted a total of about $1 9 billion to 147 cities to implement their programs The grants ranged from $750,000 for Pikeville, Kentucky, to $65 million for New York City.

A local Model Cities Program consists of (1) a 5-year comprehensive demonstration plan which describes the needs of the city in terms of projects required to make a substantial impact on social, economic, and physical problems of the city and (2) annual "action" plans which outline projects to be implemented each year. According to HUD guidelines, a program, to be eligible for Federal financial assistance, should (1) be comprehensive, (2) coordinate and concentrate the efforts and resources of Federal, State, and local agencies, (3) include new and imaginative proposals, and (4) have a substantial impact on the conditions of life and the quality of the environment in the model neighborhood

At the outset of the program, HUD advised each city to limit the size of its model neighborhood to approximately 10 percent of the population of the city. HUD stated that the neighborhood selected by a city must be of a size convenient for demonstrating--within a few years--measurable results of programs which deal effectively with neighborhood problems.

FRESNO MODEL CITIES PROGRAM

In December 1967 HUD selected Fresno to participate in the Model Cities Program and granted it $143,630 to develop a comprehensive demonstration plan HUD awarded Fresno a supplemental grant of $2,818,000 for its first action year, which began in November 1969 HUD granted identical amounts for the second and third action years which began on March 1, 1971, and March 1, 1972, respectively. The Fresno CDA spent about $5 million of supplemental funds by February 1972, the end of the second action year. CDA used these funds for administrative purposes and for funding projects operated by local agencies.

The Fresno model neighborhood encompasses an area of about 9 square miles and includes about 28,000 people, or about 9 percent of the city's population. Located west of the central business district, it is one of the city's oldest residential sections. A map showing the model neighborhood is included as appendix II.

According to data the city submitted to HUD, there is a major concentration of minority groups in the model neighborhood area. Population estimates show that the neighborhood includes about 69 percent blacks and about 22 percent Mexican-Americans.

The neighborhood residents have the lowest levels of income and educational attainment in the city, and the neighborhood has the highest proportion of substandard housing in the city. In 1967 the median income was $7,700 for families in the city at large, but 36 percent of the neighborhood families had incomes below $3,000.

According to CDA, unemployment is a major problem in the model neighborhood. The city's comprehensive demonstration plan of August 1969 showed that the unemployment rate in the model neighborhood was about 20 percent compared with 6.9 percent for the city at large.

Fresno, which has a city council form of government, established CDA in December 1967 to develop and administer its Model Cities Program. CDA, which functions as a separate department of the city, established a citizens' organization to provide resident participation in the program. Projects proposed by CDA and the citizens' organization are subject to the approval of the city council An organization chart showing the relationship of CDA to the city government is included as appendix III.

FRESNO WEST DEVELOPMENT COMPANY

The company was organized by CDA and incorporated in California in March 1969--during the Fresno Model Cities planning period--to establish a comprehensive economic development effort in the model neighborhood The company is governed by seven directors who are representatives from the model neighborhood and from the business and professional community. The directors elect the company's officers.

On January 30, 1970, the company entered into a contract with CDA to provide economic development services, such as arranging small business loans and providing job training for model neighborhood residents, beginning February 1, 1970. The contract was amended to provide such services through the third action year which ended February 28, 1973.

CDA provided supplemental funds of $709,663 and $828,989 during the first and second action years, respectively, to the company. In addition, the company received a net total of about $451,000 from other sources, such as the city of Fresno and local banks, during the first and second action years. CDA budgeted $650,000 for the company's third action year.

The objective of the company's economic development efforts was to increase business activity and meaningful employment opportunities in the model neighborhood. The company initiated two approaches to accomplish this objective (1) the recruitment of industries to locate in the model neighborhood and (2) the development of small businesses to increase opportunities for resident entrepreneurs.

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When the city began its third action year in March 1972, the Fresno West Development Company changed its name to the Fresno Development Company. The top management of the company changed, a new executive director was hired in April 1972 and the number of directors was increased from 7 to 15.

CHAPTER 2

INDUSTRIAL RECRUITMENT

Our review of the seven industrial recruitment projects implemented by the company during the first 2 action years of the Model Cities Program showed that

--Sustained employment opportunities had not been created for model neighborhood residents because five projects had been discontinued and the remaining two projects were in the early stages of development

--The company had not adequately evaluated the feasibility of proposed projects

--The company had not obtained property appraisals prior to acquiring land for project sites The prices paid for land for two projects exceeded those paid for comparable lands sold in the same general areas

--The company had not coordinated its land purchases with the redevelopment agency and thus had not obtained the benefit of the agency's real estate and land development expertise

INDUSTRIAL RECRUITMENT PROJECTS

The company implemented the seven industrial recruitment projects at a total cost of about $1,985,000. Five of these projects--which were separate and privately owned businesses--also received funds from other sources, such as grants from the Department of Labor and loans from the Small Business Administration (SBA) and local banks The company guaranteed repayment of these loans The development company directly operated the two remaining projects

The seven projects were primarily to provide jobs for model neighborhood residents Although the seven projects did create some temporary jobs, they did not create any permanent jobs The projects' objectives and their cost to the company are shown below.

Project	Objective	Cost
Kearney-Marks	Construction of residential dwellings	$ 57,000
Fig-Annandale	Construction of residential dwellings	93,000
Interior Environments, Inc	Manufacture of furniture	404,000
Fresno Industries, Inc	Manufacture of small cars (dune buggies)	360,000
Hy-Lo Camper	Manufacture of campers	205,000
Fruit-Church industrial park	Development of an industrial park.	186,000
Fresno West industrial park (note a)	Development of an industrial park	680,000
Total		$1,985,000

[a]Operated by development company

SUSTAINED EMPLOYMENT OPPORTUNITIES NOT CREATED

HUD guidelines, provided to CDAs in 1967 to assist them in developing local Model Cities Programs, state that economic development projects should be designed to reduce unemployment and underemployment in model neighborhoods

The company's industrial recruitment efforts during the first 2 action years of the program did not result in any sustained employment opportunities However, some model neighborhood residents may have benefited from work experience during their brief employment by the projects

Of the seven industrial recruitment projects, two projects--Fruit-Church and Fresno West industrial parks--were in only the early stages of development when we completed our fieldwork The other five projects--Kearney-Marks, Fig-Annandale, HY-Lo Camper, Fresno Industries, Inc , and Interior Environments, Inc --costing about $1.1 million did not accomplish their objectives and were discontinued The first three of the five projects never progressed to the point where the planned production was initiated

--Kearney-Marks--Neighboring property owners objected to the project land's being subdivided for residential dwellings, and the company withdrew its rezoning application The project land was not in the model neighborhood

--Fig-Annandale--The group of contractors organized to operate the project disbanded because of internal dissension

--Hy-Lo Camper--A source of financing, other than the company, could not be arranged

Under the two other projects, which did not meet their objectives, manufacturing activity was started and model neighborhood residents were employed for a short time

--Fresno Industries, Inc --The project began operations in April 1970 and hired 129 model neighborhood residents for on-the-job training. Some residents were referred to Fresno Industries, Inc , by the federally supported Concentrated Employment Program Shortly after April 1971, Fresno Industries, Inc., went out of business because of the lack of funds and because there was no market for its product Followup reports prepared by the Concentrated Employment Program showed that 22 of the 87 residents who had completed on-the-job training with Fresno Industries, Inc , had obtained related employment However, officials of the Concentrated Employment Program told us that their followup efforts had not included verification of employment About $625,000--including about $360,000 of Model Cities funds and the remainder from the Department of Labor, SBA, and a local bank--was spent on this project

--Interior Environments, Inc --The project began operations in June 1971 and hired 46 employees, 25 of whom were from the model neighborhood In December 1971 the plant was closed due to insufficient operating funds About $404,000 of Model Cities funds was spent on this project

The industrial park projects--Fruit-Church and Fresno West--both were long-term activities and were in the early stages of their development when we completed our fieldwork

A synopsis of the seven industrial recruitment projects is included as appendix IV

NEED FOR COMPANY TO EVALUATE FEASIBILITY OF PROPOSED PROJECTS

HUD guidelines require Model Cities operating agencies to evaluate the feasibility of projects before spending Model Cities funds In addition, HUD guidelines and the company's contract with CDA required the company to review and evaluate the (1) value of each proposed project to the model neighborhood, (2) capability of the individual or enterprise proposing to undertake the project, and (3) economic feasibility of the project The company was required to submit information on the basis used for selecting each project to CDA for its review and approval The company did not make the required evaluations

In addition, as a result of the large amount of outstanding liabilities in the industrial recruitment projects as of the end of the second action year, the company will have only limited funds available in future years to carry out the two remaining industrial recruitment projects, unless additional funds are received from HUD or other sources

Evaluation and approval of proposed projects

Our review of documentation on the five industrial recruitment projects that had been discontinued showed that the company had not evaluated the feasibility of the proposed projects nor the capabilities of the individuals and enterprises involved with the projects For example, for the Kearney-Marks, Fresno Industries, Inc , and Hy-Lo Camper projects, the company had not evaluated the feasibility of the projects, the existence of a market to support the products, or the financial and technical capabilities of the prospective project operators If the company had made such evaluations, it would have been in a better position to determine the soundness of the proposed projects and their potential for success

CDA officials told us that they had not received for their review and approval the information on the basis for the company's selection of the industrial recruitment projects. These officials said that they had relied entirely on the company to select, evaluate, and approve the projects

In an evaluation report dated October 1971 to CDA on the Fresno Model Cities Program, a management consultant firm hired by CDA said that the company should perform meaningful project feasibility studies prior to approving proposed projects The report stated that the company (1) relied too much on information furnished by individuals proposing projects, (2) lacked important facts concerning the marketability of projects, and (3) lacked qualified personnel to verify qualifications of individuals proposing projects and to identify defects in project plans submitted by those individuals

Financial involvement in industrial recruitment projects

The following chart shows, as of February 29, 1972--the end of the second action year--the funds spent and the liabilities incurred by the company on the seven industrial recruitment projects and the related assets acquired

Project	Expenditures	Liabilities	Assets
Kearney-Marks	$ 22,000	$ 35,000	$ 50,000
Fig-Annadale	36,000	57,000	74,000
Interior Environments, Inc	354,000	50,000	-
Fresno Industries, Inc	118,000	242,000	225,000
Hy-Lo Camper	195,000	10,000	102,000
Fruit-Church industrial park	104,000	82,000	82,000
Fresno West industrial park	132,000	548,000	650,000
Total	$961,000	$1,024,000	$1,183,000

In view of the company's annual Model Cities funding--the company received $600,000 from CDA for the third action year--the amount of outstanding liabilities will be a major factor in future decisions concerning the use of the company's funds To a large extent, any Model Cities funds received in future action years will be needed to meet liabilities Consequently the company will have only limited funds available to carry out the two industrial park projects, which are in early stages of development, unless (1) its allocation of Model Cities funds is increased, (2) its real estate holdings from discontinued projects are liquidated, or (3) it obtains funds from other sources

NEED FOR APPRAISAL OF PROJECT SITES BEFORE ACQUISITION

Although HUD guidelines do not require Model Cities operating agencies to have project sites appraised prior to acquisition, we believe that such appraisals are needed to help insure that the prices paid for project sites are in line with prevailing market prices Other HUD programs involving the acquisition of land, such as the Urban Renewal Program, require that properties be appraised prior to acquisition

The company acquired land and buildings for five of its industrial recruitment projects at a cost of about $958,000, and, except for the property acquired for the Fresno West industrial park, did not have the properties appraised prior to purchase The purchase prices for properties for two of the four other projects--Fresno Industries and Fruit-Church industrial park--appeared to be comparable to prevailing prices in the area The prices paid for the properties for the Fig-Annandale and Kearney-Marks projects--arrived at through negotiations between the company and the sellers--exceeded those paid for comparable lands sold in the same general area

In the Fig-Annandale project, the company purchased 18 4 acres of undeveloped land in June 1971 for about $74,000, or approximately $4,000 an acre. Adjacent, comparable land has recently been appraised and/or sold for $2,500 to $3,000 an acre.

In March 1971 the company purchased 18 5 acres of undeveloped land for the Kearney-Marks project for about $50,000, or approximately $2,700 an acre The company decided to sell the land 7 months after its acquisition A local savings and loan association told the company that it would not be prudent for a buyer to pay more than $45,000 for the property and that a buyer would not pay that amount unless (1) the property were rezoned, (2) all city utilities were available, and (3) the city accepted the buyer's development plans.

COORDINATION OF PROJECT PLANS WITH REDEVELOPMENT AGENCY

The Model Cities Act provides for a comprehensive attack on the social, economic, and physical problems in the slum and blighted areas of Model Cities through concentrated and coordinated efforts of Federal, State, and local public and private agencies in the Model Cities Program

The company did not coordinate its land purchases with those of the redevelopment agency prior to developing project plans and selecting project sites The redevelopment agency is responsible for developing and implementing HUD's Urban Renewal Program in Fresno We believe that closer coordination between the two agencies would have provided the company with the benefits of the real estate and land development expertise of the redevelopment agency

The redevelopment agency's projects are intended to bring decent housing to Fresno's urban renewal area, which includes most of the model neighborhood, and to encourage the development of industrial sites When we completed our fieldwork, the redevelopment agency had numerous parcels of cleared land available for housing projects in the model neighborhood area and was developing several industrial parks adjacent to the model neighborhood

Officials of the redevelopment agency told us that the company had not contacted them concerning (1) the possible use of urban renewal land for the company's projects, which included two housing projects, or (2) the coordination of the company's planned industrial parks with the park the redevelopment agency was developing

The former director of the company told us that he had not contacted the redevelopment agency because the company was not interested in obtaining urban renewal land for its projects

RECOMMENDATIONS TO THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT

We recommend that HUD insure that, before the company undertakes projects, CDA enforces its requirements that the company (1) evaluate the feasibility of proposed projects and (2) submit information on the basis for project selection to CDA for review and approval.

We recommend also that HUD (1) have CDA require the company to coordinate its efforts with the redevelopment agency and (2) revise its guidelines to require appraisals of the fair market value of properties to be acquired for Model Cities projects

AGENCY COMMENTS

HUD stated that, although numerous errors in decisions and procedures related to increasing employment opportunities were evident in the company's first 2 years of operation, recent developments were encouraging HUD told us that in November 1972 the company, SBA, and a local bank made a loan of $400,000 to Architectural Wood Products, Inc , for a new business in the model neighborhood and that, according to the company, 29 persons were employed in the business and others were being hired In addition, HUD said that the company was trying to recover or develop prior investments in real property and that it had given priority to developing the Fruit-Church and Fresno West industrial parks

HUD stated that further encouragement about increasing long-term job opportunities for model neighborhood residents was contained in a statement from the new director of the company that any future projects undertaken by the company must insure sustained and lasting employment opportunities for residents HUD stated also that the company had established new lines of communication with the redevelopment agency and had committed itself to fully cooperating with the redevelopment agency on all present and future projects

HUD said that the company had improved its (1) evaluation of proposed projects and (2) review and disposition of properties acquired for current projects that failed to achieve their objectives HUD stated also that the company had adopted a policy of requiring professional appraisals of all real property under consideration for future acquisition or sale

CHAPTER 3

SMALL BUSINESS DEVELOPMENT

The goal of small business development under the Fresno Model Cities Program was to develop and assist resident-owned small businesses that would provide employment for model neighborhood residents Under the small business development program, the company made loans to resident businesses on its own and in cooperation with local banks and SBA

During the first and second action years, the company made 46 loans to businesses and participated, with other lending institutions, in 3 loans The 49 loans made by the company amounted to $218,844. We reviewed 18 company loans totaling $53,945 and the three joint loans, of which the company's share was about $78,000. Together, these loans totaled $131,969, or about 60 percent of the total loans made by the company The businesses assisted by the 21 loans had created only three full-time jobs for model neighborhood residents

HUD guidelines require CDAs administering loan programs to establish criteria for determining the eligibility of business ventures for financial assistance Accordingly, CDA established the following criteria for small business development loans made by the company

1. A loan must be for a business venture owned by and/or employing model neighborhood residents

2. The company must prepare a written analysis of the feasibility of the business venture and the financial and technical ability of the loan applicant that is to undertake the venture

3. A loan not involving participation with another lending institution may not exceed $5,000

COMPANY LOANS

Our review of the 18 direct loans made by the company--which totaled $53,945--showed that as of February 29, 1972, 7 of the 18 businesses that received loans were still operating Nine of the loans were delinquent in the total amount of $5,850, and six of the loans were in default by $14,074 and had been written off The 18 loans had created only 10 new jobs for model neighborhood residents--8 part-time and 2 full-time jobs.

We believe that, had adequate evaluations of proposed ventures been made and had proper internal controls been exercised over loan approvals, the company might have been able to more prudently select business ventures capable of achieving the goals of the business development loan program We believe also that the company should strengthen its loan collection efforts.

Evaluations of feasibility of business ventures prior to making loans

Prior to awarding 8 of the 18 loans, the company inadequately evaluated or did not evaluate the feasibility of the business ventures. Of these eight loans, four loans totaling $15,800 were made to establish owner-operator trucking businesses The company did not investigate the need for additional trucking businesses in Fresno or the prospect of the loan applicants' succeeding in this business Loan applications, which were to be used by the company to obtain basic information on the proposed ventures, were not required from two of the four applicants, and the loan applications submitted by others were incomplete

Internal controls over approval and disbursement of company loans

Our review showed that

--Loans had not been approved by the company's board of directors, contrary to company operating procedures

--Loans in excess of $5,000 had been made by the company, contrary to the requirements of the CDA-company contract

--Loans had been approved by unauthorized persons.

--Loans had been made for purposes that were inconsistent with the goals of the small business development program.

Company procedures required that loans be approved by the company's board of directors Of the 18 loans we reviewed, 4 had been made by the company without the approval of its board of directors. The four loans totaled $12,015.

The company's contract with CDA provided that the company not make loans in excess of $5,000. Four loans totaling $23,764 exceeded this limit As of February 1972, $1,442 of the $5,000 outstanding balance on one of these four loans was delinquent and two of the other loans totaling $11,163 had been written off by the company

The company employed a loan officer who was responsible for approving small business loans. Of the 18 company loans we reviewed, 15 had been approved by someone other than the loan officer--usually the former executive director or his administrative assistant The loan officer, whose services were terminated by the company in January 1972, told us that some of the loans had been made even though he had refused to approve them He said that he had been bypassed on many loans

The former executive director told us that some persons who received loans were persons who could not get loans from private lending institutions and therefore were high risks He said also that a large number of small business failures were to be expected, but he agreed that the company, prior to approving loans, should more carefully evaluate small business ventures and the ability of the loan applicants to undertake the ventures

Purpose of loans inconsistent with objectives of the company's loan program

Of the 18 direct loans we reviewed, 3 had been made for purposes that were inconsistent with the company's objective of increasing the level of business activity and resident employment by assisting the development of small businesses One loan of $2,000 was made to enable the recipient to purchase a home. Another loan of $300 was made to pay funeral expenses for the recipient's wife

A loan of $700 was made to the operator of a small grocery business for the purchase of inventory The grocery store operator applied for a $5,000 loan but, according to the company's manpower coordinator, because of his inexperience in the grocery business and the unstable financial condition of his business, the company was reluctant to loan him that amount The company's former executive director told us that he had approved the loan for $700 with the hope that the grocery store operator would use the profits from the sale of the inventory to pay off his outstanding debts and then voluntarily get out of the grocery business.

Company needs to strengthen efforts to collect delinquent loans

The company needs to strengthen its efforts to collect delinquent loans. As of February 1972, 9 of the 18 direct loans we reviewed had been delinquent from 2 to 24 months and 6 loans amounting to $14,074 had been written off by the company.

We examined the files on the nine delinquent loans to determine the extent of the company's collection efforts Of these nine files, four had copies of recent letters from the company requesting payment of the loans, three had no such letters, and two had one or two noncurrent, past-due payment notices

In January 1972 the company established guidelines for its loan program The guidelines stated that daily followups should be made on delinquent loans but did not establish detailed collection procedures nor designate any member of the company's staff to make such followups The guidelines stated also that higher priority should be given to salvaging a business than to collecting a loan from that business.

The company eliminated the small business development program from the third action year of the program At the completion of our fieldwork, the company had assigned two people to collecting delinquent loans.

JOINT LOANS

The company participated with other agencies in three joint loans during the first 2 action years. The company acted as a guarantor for the SBA and local bank parts of these loans, as shown below.

Business	Loan amount Company	SBA	Bank	Total
Twentieth Century West (note a)	$28,124	$ 69,750	$ 69,750	$167,624
Manning Gardens	35,300	100,000	217,700	353,000
Happy Steak	[b]14,600	65,700	65,700	146,000
Total	$78,024	$235,450	$353,150	$666,624

[a]Company, SBA, and bank loans were delinquent in the amounts of $1,377, $4,409, and $1,628, respectively, as of March 1, 1972

[b]Delinquent in the amount of $489 as of April 19, 1972

Descriptions of the three businesses that received the loans follow

Twentieth Century West

The Twentieth Century West project was to construct a restaurant, a cocktail lounge, and meeting rooms designed to serve as the center of community activities for the residents of the model neighborhood and of the greater Fresno area During the first and second action years, the company assisted in developing plans and securing funds for the project Construction of the building began in August 1971, and the business opened in July 1972.

Manning Gardens

The Manning Gardens project was to add a new wing to a convalescent hospital located in the model neighborhood The wing was expected to generate employment for 23 people. At the completion of our fieldwork, the construction had been completed. The new wing opened on June 5, 1972

Happy Steak

> When we completed our fieldwork, a new meat-processing plant for the Happy Steak project had been constructed The plant, which supplied packaged meat to 23 Happy Steak restaurants, opened February 15, 1972

The company's objective in participating in the three joint loans was to provide employment opportunities for model neighborhood residents The Twentieth Century West and Manning Gardens projects were not operating when we completed our fieldwork, the Happy Steak project was operating but was employing only one model neighborhood resident Our examination of the loan arrangements and discussion with representatives of the three businesses revealed that commitments had not been made to hire model neighborhood residents in either the Twentieth Century West or the Happy Steak projects The owners of Manning Gardens, however, had advised the company that Manning Gardens would hire 23 model neighborhood residents

The Happy Steak meat-processing plant opened with 14 employees, including three from the model neighborhood By April 1, 1972, two of the model neighborhood residents had been dismissed

As of the end of the second action year, February 1972, payments due the company from the Twentieth Century West and Happy Steak projects were delinquent by a total of $7,902 In addition, through April 1972 the company had paid $7,000 to the bank and SBA on behalf of the Twentieth Century West project

As of May 16, 1972, the installment notes establishing Twentieth Century West's liability for its $167,624 loan from the company had not been signed by the borrower After we brought this matter to their attention, company officials had the notes signed

CONCLUSIONS

To the time of our fieldwork, the small business development program had had a limited impact on the level of business ownership by, and employment for, model neighborhood residents The rate of success of the business ventures for which loans were granted was low, resulting in defaulted and delinquent loans and few employment opportunities for model neighborhood residents

As previously mentioned, the small business development component of the economic development program was dropped from the company's third action year program.

RECOMMENDATION TO THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT

We recommend that HUD have CDA require the company to take appropriate action to collect all delinquent small business development loans.

AGENCY COMMENTS

HUD stated that the repayment of loans to the company by the Twentieth Century West, Manning Gardens, and Happy Steak projects was current and that model neighborhood residents were being employed by the three businesses Litigation had been entered into for other delinquent accounts to minimize the amount of the delinquencies. HUD stated further that the company currently had one staff member assigned to collections In addition, HUD officials informed us that the company was encouraging local banks and other lending institutions to make loans to small businesses

CHAPTER 4

FINANCIAL MANAGEMENT

In June 1969 HUD established financial management guidelines for CDAs These guidelines required that CDAs include in their financial records complete explanations of all expenditures The guidelines also included criteria for the types of costs eligible for payment from Model Cities funds

The CDA's first- and second-year contracts with the company required that the company adhere to HUD's financial management guidelines The CDA-company contracts also required that the company submit all contracts for services to CDA for approval The company, however, did not always comply with HUD's guidelines or the requirements of its contracts with CDA

REVIEW OF JANUARY 1972 DISBURSEMENTS

To test the adequacy of the company's compliance with HUD's guidelines and with its contract with CDA, we reviewed the company's support for the $30,037 disbursed during January 1972 and found that expenditures in the amount of $5,621 either were not fully supported or were ineligible for payment from Model Cities funds. Of the $5,621, $2,411 was not (1) included in the company's budget approved by CDA, (2) eligible according to HUD guidelines, or (3) fully supported, as discussed below

- --The company's approved budget authorized funds for 11 staff positions, however, the company had 13 staff members during the month This resulted in salary expenses of $1,668 that were not authorized by CDA Company officials told us that, due to an oversight, they had failed to request funds for the two additional staff positions

- --Without the approval of CDA or the company's board of directors, the company had increased the acting executive director's salary from $16,000 to $18,000 During January 1972 this increase resulted in unauthorized salary expenses of $167 In February 1972 the acting executive director's salary was reduced to $16,000

--The company had paid $151 for food served at a meeting and Christmas party held in December 1971 for the company's staff and its board of directors CDA auditors had told company officials prior to the expenditure that such an expense was ineligible according to HUD guidelines and would not be allowed The expenditure was subsequently disallowed by CDA

--The company had not recorded in the telephone log, contrary to CDA requirements, $221 for long-distance phone calls

--The company had purchased law books and legal forms costing $204 It appears that this purchase was unnecessary because the company contracted for all required legal services

Payments to contractors for the remaining $3,210 were not fully documented HUD requires that payments to contractors be fully documented in the company's files

The company's contract with CDA requires that all company contracts for services be submitted to CDA for review and approval Also the company is required to document its justification for noncompetitive procurement of services and, for contracts for consultant services, the reasons for selecting the consultants However, no written agreements had been executed to support $1,210 paid to two consultants Another consultant (the former executive director of the company), under a contract dated December 31, 1971, received $1,500, although the services he performed during the month were not fully documented The payment was supported by a preprinted form containing a very brief pro forma statement attesting that the duties specified in his contract had been performed The contract file also contained several presigned and undated copies of this form

The contract with the former executive director contained statements as to the services he was to perform for a yearly fee of $18,000 In March 1972 the board of directors asked for his resignation because of insufficient reports on his activities and because he was not producing the results expected He refused to resign and continued as a consultant to the company until his contract expired in December 1972

Under a contract the company spent $500 for stenographic services which were supported only by an unsigned, preprinted form containing a statement by the contractor attesting, in advance of performance, that the duties had been performed This payment, in our opinion, was not adequately supported

REVIEW OF ADDITIONAL COMPANY EXPENDITURES FOR CONTRACTUAL SERVICES

Because the company spent a large amount of funds for various contractual services, we reviewed selected expenditures the company made for such services during its first 2 action years and found that payments amounting to about $258,200 were made by the company to 86 contractors CDA officials told us that, contrary to CDA requirements, none of the 86 contracts had been submitted to CDA for review and approval but that CDA would enforce such requirements during the third action year

We reviewed expenditures totaling $145,867 made to 22 contractors and found that the company (1) had paid 4 contractors a total of $22,971, although written contracts had not been executed, (2) had paid 5 contractors fees totaling $21,131 for services which were performed after the contracts expired or which exceeded the total contract amounts, and (3) had paid 12 contractors fees totaling $62,345 although the contractors had not submitted proof that they had performed the required services Also, although the contracts we reviewed had been awarded on a noncompetitive basis, the company, contrary to CDA requirements, had not justified the noncompetitive procurements

Following are examples of weaknesses in the company's administration of contractual services

Example A

The company assisted a group of small building contractors to form a corporation so that they could pool their resources and obtain construction contracts which would have been too large for any of them individually The company later entered into a contract with the new corporation that provided for the company to pay the salary of the corporation's general manager The contract required the corporation to submit to the company monthly statements of the duties performed by the general manager Although the corporation had not submitted such statements, the company paid the corporation--for the period October 31, 1970, to June 1, 1971--$14,000

Example B

The company paid a firm $16,175 for locating a business that would move into the model neighborhood The contract provided that the fee be based on the capital investment of the new business but did not specify the basis to be used in determining the amount of such investment The fee paid by the company was based on a capital investment of $273,500 which consisted almost entirely of loans either made by or guaranteed by the company The assets of the new business were valued at about $1

- - - -

CDA established control over the company's expenditures during the third action year The company was required to submit to CDA all purchase orders and supporting documents, including information justifying each expenditure CDA officials informed us that CDA was reviewing all company purchase orders and, in the future, would review all the company's consulting arrangements

CHAPTER 5

CDA MONITORING AND EVALUATION

OF COMPANY'S PERFORMANCE

HUD guidelines require CDAs to monitor and evaluate the activities of agencies operating Model Cities projects. These evaluations, which should be made timely, (1) should help determine whether the agencies, through the approved projects, are accomplishing their objectives and (2) should be a basis for revising projects to make them more effective or for terminating projects that have little potential for success

Contrary to HUD guidelines, the Fresno CDA did not monitor and evaluate the company's activities during the first 2 action years We believe that proper monitoring and evaluation of the company's activities would have disclosed the weaknesses in the company's industrial recruitment, small business development, and financial management activities discussed in this report

LACK OF MONITORING AND EVALUATION BY CDA

During the first 2 action years, the Fresno CDA did not monitor and evaluate the company's activities CDA, however, did hire a consulting firm to review selected Model Cities projects, including the company's projects, but this was done only after HUD auditors noted major deficiencies in the company's activities The consultant's report was not issued until the middle of CDA's second action year and therefore its value as a basis for timely revising or terminating any of the company's second-year projects was limited

The report concluded that

1 The company had not given CDA sufficient information on its activities to allow CDA to monitor and evaluate the company's performance

2. The company invested in the small business development program amounts that were very high compared to the few businesses that were established Also the small business development program's impact on unemployment in the model neighborhood was limited

3 The company's industrial recruitment objectives were unrealistic and needed to be redefined.

4 The company was not making quality and complete project feasibility studies

City officials informed us that the lack of effective monitoring of the company's activities was, to some extent, due to statements made by HUD representatives concerning CDA's proper role in project monitoring For example, according to city officials, a HUD representative advised the city controller in a September 1970 meeting that CDA was not responsible for operating agencies' activities beyond making postaudits of their operations The city controller noted, however, that this advice was contrary to HUD guidelines

According to information in CDA's files, HUD regional office representatives told CDA officials in June 1971 that they were taking too active a role in the operations of the company and that they should be concerned only with monitoring activities and postaudits and should not be concerned with anything prior to the expenditure of funds Consequently CDA requested a letter from the regional office spelling out the extent to which CDA should become involved in the company's operations.

In July 1971 the San Francisco regional office advised CDA that, to properly carry out its monitoring functions, CDA would have to (1) develop a set of goals, standards, project selection criteria, and operating procedures for the company to delineate CDA's operations and (2) monitor performance against the established goals and standards to insure that the company was carrying out its responsibilities

CDA ACTION TO IMPROVE MONITORING

CDA has acted to correct weaknesses in its monitoring of the company's activities The contract for the third action year emphasized that the company was to provide CDA with information adequate for CDA to review and approve the company's proposed contracts, projects, and loans The company was required to submit monthly activity reports to CDA, and CDA, not less than quarterly, was to perform in-depth reviews of the progress and effectiveness of all the company's projects In addition, CDA hired a consultant to develop guidelines for the company to help the company conduct the economic development program and to help CDA improve its monitoring capabilities.

These corrective actions should provide a basis for improved monitoring and evaluation of the company's programs

B F SISK
16TH DISTRICT CALIFORNIA

COMMITTEE ON RULES

COMMITTEE ON AGRICULTURE

HOUSE OFFICE BUILDING
WASHINGTON D C 20515

CONGRESS OF THE UNITED STATES
HOUSE OF REPRESENTATIVES
WASHINGTON, D C 20515
February 17, 1972

TONY COELHO
ADMINISTRATIVE ASSISTANT

DISTRICT OFFICE:
BETTY CLOUGH CORNELIUS
FIELD REPRESENTATIVE
ROOM 2001
FEDERAL OFFICE BUILDING
1130 O STREET
FRESNO CALIFORNIA 93721
209-487 5004

Mr. Elmer B. Staats
Comptroller General of the
United States
GAO Building
441 "G" Street, N. W.
Washington, D. C. 20548

Dear Elmer

As you know, your Agency, acting upon my request of May 14, 1971, has monitored an audit conducted by the IX Regional Office of the Department of Housing and Urban Development of the Model Cities Program of Fresno, California.

This audit resulted in 6 major findings concerning the operation of the Fresno program which the Regional Director ordered the local agency to correct and improve. It appears that solutions to 5 of the major problems are well under way, but one of the findings, Number 4 of the HUD audit, relative to the operations of the Fresno West Development Corporation, leaves many unanswered questions.

I am enclosing a photostatic copy of a letter I have received from the Honorable Ted C. Wills, Mayor of Fresno, sent with the approval of the City Council, requesting that an immediate and thorough independent audit be conducted by GAO of the operations of the Fresno West Development Corporation since its inception up to the present time.

I agree wholeheartedly with this approach and respectfully request and urge you to immediately proceed with such an audit.

Sincerely,

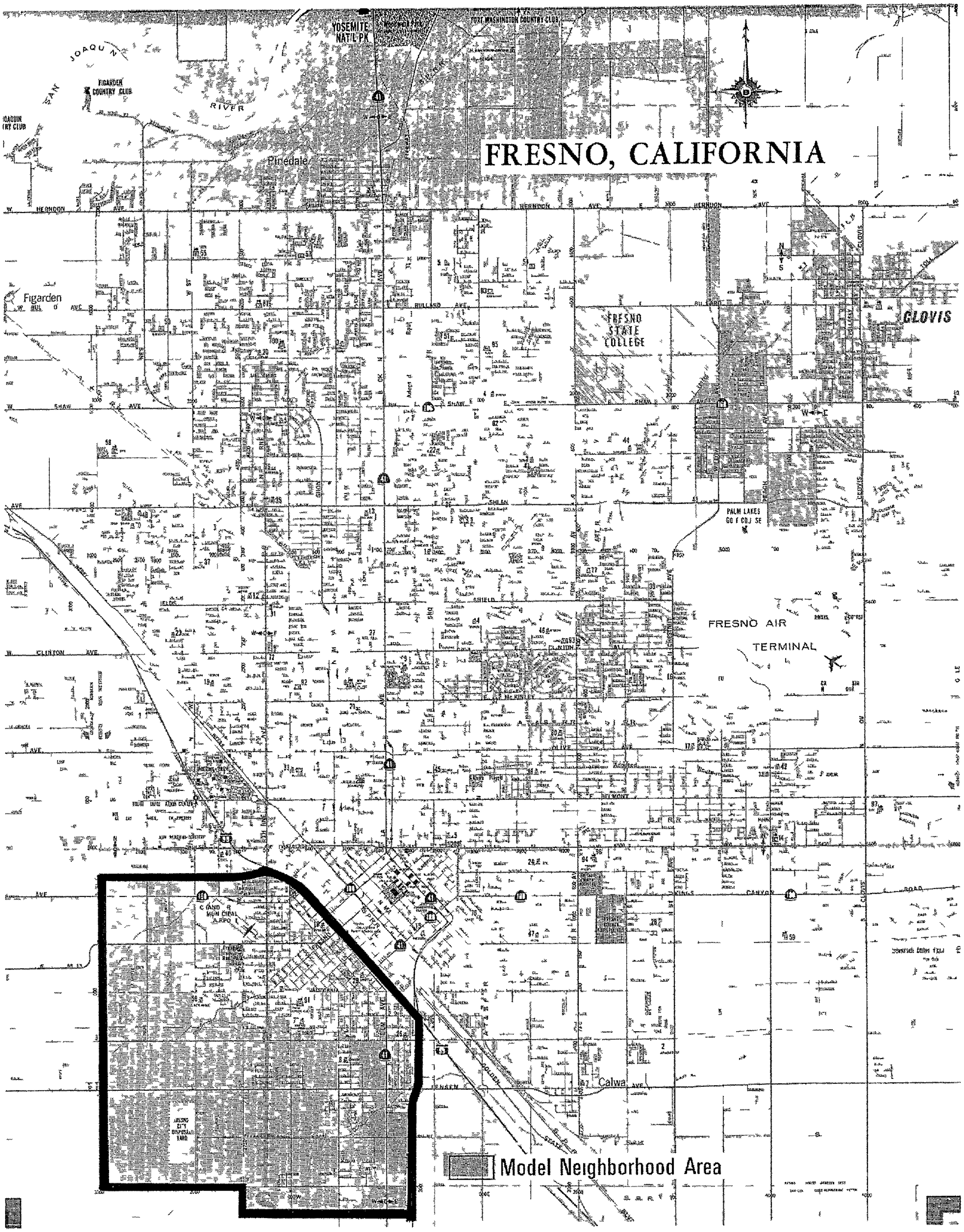
Bernie

B. F. SISK
MEMBER OF CONGRESS

BFS mc/em

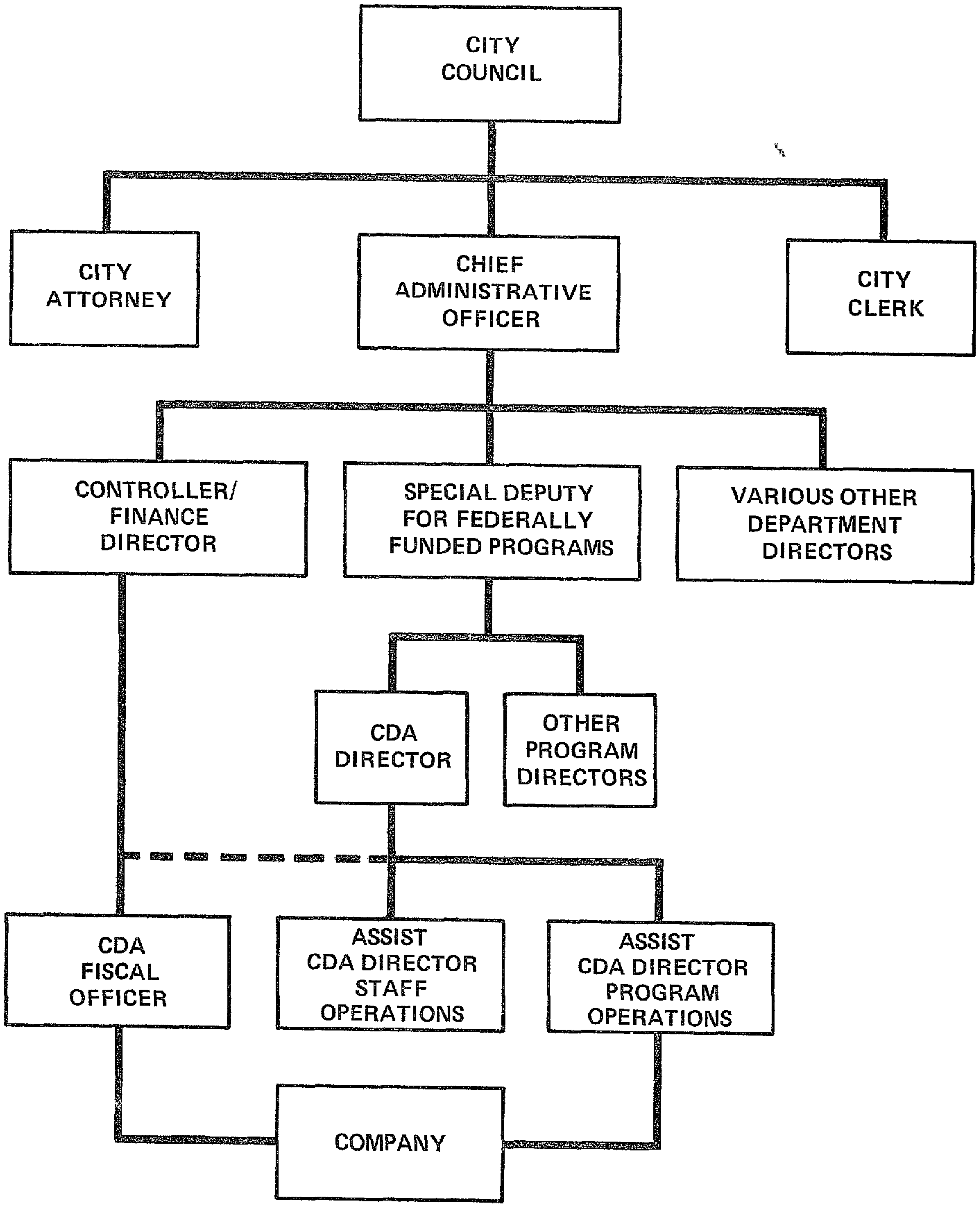
Enclosure

APPENDIX II



FRESNO, CALIFORNIA
YOSEMITE NAT'L PK
FORT WASHINGTON COUNTRY CLUB
SAN JOAQUIN RIVER
FIGARDEN COUNTRY CLUB
Pinedale
Figarden
HERNDON AVE
BULLARD AVE
FRESNO STATE COLLEGE
CLOVIS
SHAW AVE
PALM LAKES GOLF COURSE
SHIELDS
FRESNO AIR TERMINAL
CLINTON AVE
McKINLEY
OLIVE AVE
BELMONT
KINGS CANYON ROAD
CALIFORNIA
Calwa
JENSEN
Model Neighborhood Area

ORGANIZATION CHART SHOWING RELATIONSHIP BETWEEN FRESNO CITY GOVERNMENT, CDA, AND COMPANY AS OF MAY 1972



SYNOPSIS OF INDUSTRIAL RECRUITMENT PROJECTS

KEARNEY-MARKS

This project was to provide job opportunities and housing for model neighborhood residents and involved purchasing and subdividing land and constructing residential dwellings In March 1971 the company, without making a feasibility study of the project, paid $50,000 for about 18 5 acres of land located outside the model neighborhood and the city limits of Fresno

After neighboring property owners objected to the land's being subdivided, the company withdrew its request for the land to be rezoned and annexed by the city Subsequently the company put the land up for sale

FIG-ANNADALE

This project was to provide job opportunities and low-income housing for residents through the construction of 110 low-density housing units by model neighborhood contractors In June 1971 the company, without making a feasibility study of the project, bought 18.4 acres of land for $74,000 and, with the aid of a real estate consultant, developed plans for constructing the units.

The company's former executive director told us that the project had been unsuccessful because the group of contractors organized to do the work had disbanded due to internal dissension and insufficient financing and because the units planned for construction were overdesigned and too costly for the area The company attempted to get another developer to take over the project but was unsuccessful because that developer concluded that the project was not economically feasible

INTERIOR ENVIRONMENTS, INC

Under this project the company, without making a feasibility study, arranged for a furniture-manufacturing business to locate in the model neighborhood to provide employment opportunities for neighborhood residents

Interior Environments, Inc , began operating in June 1971 in a leased plant about 7 miles outside the model neighborhood Plant equipment, inventory, and existing product sales contracts were purchased from the previous operator of the plant About 46 people--25 from the model neighborhood--were hired to work in the plant A second plant was later opened in the model neighborhood, but both were closed in December 1971 because of insufficient working capital. Between March and December 1971, the company invested about $200,000 in the business' stock and made loans totaling about $154,000 to the business in an attempt to keep it in operation.

In March 1971 the city of Fresno assigned one of its auditors to evaluate the company's projects, especially Interior Environments, Inc As a result of the auditor's work, the company purchased controlling interest in the business in September 1971 By March 1973 criminal charges had been brought against the president of the business for the alleged misuse of funds received from the company.

Prior to approving and funding the project, the company obtained the following information concerning the president of the business

--His Los Angeles furniture plant was no longer in operation and its assets had been sold at public auction

--Allegations had been made that he had failed to adequately perform under a Department of Labor contract for work training

--The Economic Development Administration had rejected his preliminary loan application for $3 5 million for Interior Environments, Inc , because his equity capital position was too weak

--Dun & Bradstreet had reported that numerous legal suits were pending against him and that another of his companies apparently had insufficient operating capital.

At the time the company provided funds to Interior Environments, Inc , the State had suspended three of the president's other companies from conducting business for failure to file and pay State income taxes.

A city official told us that the project had been approved by the company despite the known shortcomings of the president, because (1) the company and CDA were concerned primarily with providing jobs for model neighborhood residents and (2) the president's expertise in the furniture trade was needed

FRESNO INDUSTRIES, INC

Fresno Industries, Inc (operating as Bugetta, Inc., prior to August 1970), was to create jobs for model neighborhood residents by establishing a company to manufacture small cars (dune buggies)

Prior to the plant's locating in Fresno, both SBA and the company were advised by Bugetta's president that the three owners of Bugetta had entered into an agreement of dissolution The terms of the agreement left the president and one of the other owners--both of whom were dealing with the company and were later to operate Fresno Industries--with very few assets The agreement provided that the trade name Bugetta, the prototype car, and the tooling and parts inventory went to the third owner. When the company moved to Fresno, the total identifiable assets, excluding those that were to be transferred to the third owner, were valued at about $1

A temporary plant opened in April 1970 with approximately $625,000 received from the company, CDA, SBA, a local bank, and the Department of Labor By April 1971 the $61,000 in training funds provided by the Department of Labor had been spent Shortly thereafter Fresno Industries went out of business because it lacked funds and because it had no market for its product The company, as guarantor of the loans made to the firm by SBA and the local bank, assumed a liability of about $242,000 in addition to the $118,000 the company had spent on the project

Prior to approving this project, the company did not evaluate the feasibility of the project and the financial and technical capabilities of Bugetta nor determine whether there was sufficient demand to support the mass production of dune buggies Instead, the company relied on a study SBA made in December 1969 in connection with its loan to Bugetta SBA concluded that the project appeared to be technically and economically feasible according to information supplied by Bugetta but stated that no reliable determination of market demand for the product had been made

HY-LO CAMPER

Hy-Lo Camper was to provide employment for model neighborhood residents by establishing a camper manufacturing plant The company spent approximately $195,000 of Model Cities funds on this project. The project was abandoned because the company was unable to obtain funds for the project from other sources

The company had planned to obtain funds for the project by selling stock in Hy-Lo Camper and by obtaining a $400,000 loan from SBA In June 1971 SBA disapproved the company's application for a loan for the project and expressed its belief that the company would be unable to repay the loan and that it lacked sufficient collateral to protect the Government's interest.

Between March and September 1970, the company, without making a feasibility study, purchased land and a building for the project at a cost of about $103,000 The building is a considerable distance from the model neighborhood in an area consisting primarily of vacant land The project was discontinued and the land and building were offered for sale after SBA disapproved the company's loan application

FRUIT-CHURCH INDUSTRIAL PARK

The company estimated that the 74-acre Fruit-Church industrial park would cost $3 5 million, including the cost of the land, construction of facilities, and site improvements The project was to provide employment for model neighborhood residents and to improve the area

As of February 29, 1972, the company had purchased about 17 acres of land with approximately $82,000 which it had borrowed from the city of Fresno and had options to purchase the remaining 57 acres At that time the company had spent about $104,000 on this project In addition, the company had applied for a Department of Commerce grant of about $442,900 to pay for about one-half of the cost of the site improvements As of February 1973 the grant had not been approved

FRESNO WEST INDUSTRIAL PARK

The 300-acre Fresno West industrial park, which the company estimated would cost about $3 million, was to include a food-processing complex The project was to create jobs for model neighborhood residents In June 1971 the company paid about $100,000 toward the purchase of about 99 acres of land costing $650,000

City officials informed us in April 1972 that the status of the project was uncertain because of the company's lack of funds They stated that the project might be taken over by the city These officials informed us in February 1973 that the status of this project had not changed

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON D C 20410

MAR 26 1973

OFFICE OF THE ASSISTANT SECRETARY
FOR COMMUNITY DEVELOPMENT

IN REPLY REFER TO
DMB

Mr. B E Birkle
Associate Director
Resources and Economic Development Division
U.S. General Accounting Office
Washington, D.C 20548

Dear Mr Birkle

On behalf of the Secretary I am responding to your letter of December 27, 1972, and the enclosed draft report entitled Review of the Operations of the Fresno West Development Company in the Fresno, California Model Cities Program

First, let me say that I consider the report to be generally accurate in its findings and appropriate in its recommendations
[See GAO note, p 44] In considering comments related to the first two operational years of the Model Cities program, however, it is appropriate to keep in mind that this program was conceived as a truly experimental endeavor. As an experiment, it was anticipated that some mistakes would be made, but that improved management processes and more meaningful programs by the local government would emerge.

A significant fact to remember is that when Fresno began its third action year in March 1972, it also received an additional grant as a Planned Variations city Among other things the Model Cities Program went city-wide in its scope of activities. Along with this transition affecting the City Demonstration Agency, the Fresno West Development Company became the Fresno Development Company (FDC) The top management of the Company changed as a new executive director was hired in April 1972. The Board of the FDC was increased to 15 members representing the various expanded Model Cities areas.

[See GAO note, p. 44]

[See GAO note, p. 44.]

While the report does identify a number of shortcomings in certain aspects of the Fresno West Development Company's operations for the first two years, there does appear to be evidence that these difficulties are well on their way to being overcome. In addition to the experience gained, indications from our San Francisco Area Office are that the tightening of fiscal controls and the recent change in the management of the Company has greatly reduced the potential for poor investments in the future. A basis for their attitude is further reflected in comments recently made by the Assistant Chief Administrative Officer of Fresno concerning the draft, indicating that "...the City has kept close fiscal controls on the Fresno Development Company in order to correct previous mistakes of the company."

Following is a response prepared largely by the Fresno Development Company and concurred in by the City of Fresno and the HUD Area Office. It addresses particular activities in the report.

INDUSTRIAL RECRUITMENT

While numerous errors in decisions and procedures related to increasing employment opportunities are evident for the first two years of the Company's operations, developments over the past several months are rather encouraging.

In November 1972 the FDC together with the Small Business Administration and a local bank was able to negotiate a $400,000 loan to the Architectural Wood Products, Inc. for a new facility in the area. A recent check by the FDC indicates that some 29 persons are already employed and additional employees are constantly being added.

Another property, Ak-Mak, purchased in 1970, is now in escrow. Indications are that the property is being sold to a company that will employ 40 persons. The Fresno Industries Property is currently undergoing lease negotiations. If the lease is successfully negotiated, it is anticipated that the lease will provide 35 to 40 new jobs for residents. Additionally, the equipment and inventory of Interior Environments, Inc. have been purchased by a major California furniture company. Former employees are being rehired for this operation.

FDC indicates that in addition to the above, every effort is being made to recover or develop prior investments in real property. Priority has been placed on development of their two industrial parks Fruit and Church, and Fresno West Industrial Park. The former is a combined effort with the City of Fresno and the Fresno Redevelopment Agency. Indications are that the project is currently awaiting funding from the Economic Development Administration. The Fresno West Development Park has been delayed due to lack of funds for offsite improvements. The cost of these improvements has been included in the budget for FDC for this year. FDC indicates there is interest in this property and that it is the intention of FDC to develop the property within the framework of the total 900 acres of industrial land in this area.

Further encouragement about increasing long-term job opportunities for area residents is contained in a statement from the new director of the Fresno Development Company that any future projects or new projects that the company undertakes must contain assurance of sustained and lasting employment opportunities for residents. The new management also indicates that they have established new lines of communication with the city planning agencies and the Fresno Redevelopment Agency. A commitment has been made by the FDC to fully cooperate with the Redevelopment Agency in relation to any projects either now in existence or future projects that would relate to the Agency.

There is evidence that improvements have been made in the evaluation of proposed projects and the review and disposition of current properties that have failed to produce the intended objectives. To begin, the FDC has adopted a policy of requiring a MAI (professional) appraisal on any real property under consideration for future acquisition or for sale. Every effort is also being made to recover or develop prior investments. In the case of Fresno Industries, the FDC is negotiating a lease with a new company. The FDC is selling its interest in the Fig and Annadale property for the development of 106 FHA financed housing units, thereby fulfilling the original purposes of this project. Prospects for the two industrial parks have been discussed above. Employment expectations for these activities have also been discussed previously.

SMALL BUSINESS DEVELOPMENT

The Fresno Development Company reports that in most instances the figures on loans made in the audit are consistent with their files. Collection efforts have been strengthened through the assignment of collections to a staff member.

Your report raised questions concerning delinquency of payments on loans made to three businesses Twentieth Century West, Manning Gardens, and Happy Steak. Concern was also expressed over the failure of these firms to employ model neighborhood residents. We are advised by FDC that at this time, payments on all three projects are current and residents are being employed at all three firms. Litigation has been entered into with other delinquent accounts in order to minimize the amount of such delinquencies. The company's present policy is to continue to sponsor small loans through participation with banks, lending institutions, the Small Business Administration, and the like. While providing a sounder fiscal basis for loans, direct loans will be severely curtailed

SUMMARY

While the initial period of the company under the old name and previous direction showed certain weaknesses, we are quite pleased with the recent progress made to date and the receptiveness of the company to the recommendations of HUD and GAO audits. We are encouraged that the program has been strengthened by this effort and will continue to improve its ability to provide effective results in the community. Additional cause for optimism is the City's participation in the Planned Variations effort and the changes this participation will provide. It is reasonable to expect that the expanded Board will improve its ability to arrange economic development packages. We are also advised by our San Francisco Area Office that the City Demonstration Agency staff and the Fresno Community Development Commission, the city-wide citizen participation group, are discussing the viability of the Fresno Development Company, and its ability to produce. It may be expected that these efforts will further strengthen approaches to economic development in Fresno.

It seems that the audit review has served a useful purpose.

Sincerely yours,

Warren H. Butler
Deputy Assistant Secretary
for Community Development

GAO note Material not related to this report has been deleted.